

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Telephone Number:

Refer Reply To:
CC:PSI:B02 – PLR-103181-08
Date:
July 15, 2008

Legend

X:

Properties:

Year 1:

Year 2:

Date 1:

a:

b:

Dear :

This responds to a letter dated January 21, 2008, submitted on behalf of X, requesting a ruling that X's rental income from Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that X was incorporated in Year 1. X intends to elect to be an S corporation beginning Date 1.

The information submitted states that X, in its capacity as owner, provides services directly or indirectly to tenants renting Properties. The services provided to some or all of Properties by X include but are not limited to the following: recruiting and approving new tenants; negotiating all leases, renewals, and other agreements with tenants; marketing available units for rental; communicating with tenants on all issues relating to the management and operation of the various properties, including maintenance and repairs, providing for maintenance, landscaping and snow removal from the parking and common areas; maintaining the interior and exterior of various properties, including refurbishing, painting and repairing as necessary to ready units for new tenants; supervising all development and construction pertaining to the various properties; and handling legal and accounting matters arising in the normal course of business.

X's annual expenses excluding depreciation in Year 2 were \$a. The annual gross rental income for Year 2 was \$b.

Section 1361(a)(1) defines "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation—(I) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Section 1362(d)(3)(C)(i) defines "passive investment income" as gross receipts from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5) of the Income Tax Regulations provides, in relevant part, that in general "passive investment income" means gross receipts derived from rent.

Section 1.1362-2(c)(5)(ii)(B)(1) provides that "rents" means amounts received for the use of, or right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that "rents" does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including, but not limited to, the number of persons employed to provide the services, and the types and amounts of costs and expenses incurred (other than depreciation).

Based solely on the facts and representations submitted, we conclude that the rental income X receives from Properties is not passive investment income as described in § 1362(d)(3)(C)(i).

Except for the specific ruling above, we express no opinion concerning the federal income tax consequences of the transactions described above under any other provision of the Code. Specifically, we express or imply no opinion on whether X is a small business corporation. Further, the passive investment income rules of § 1362 are independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

Melissa C. Liquerman
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
Passthroughs & Special Industries

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: